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SUBJECT: FINANCING MINERAL EXTRACTION IN ERITREA: WHO WILL  
PAY?

CLASSIFIED BY: AMB Scott H. DeLisi, for reasons 1.4 (b)  
and (d).

REFTEL: ASMARA 250

¶1. (C) Summary: Despite on-going concerns about the practicality of foreign investment in Eritrea, private mining companies continue to actively seek foreign investors to bankroll the mineral extraction. Since March several development banks, private banks and private companies have traveled to Eritrea to further explore the viability of investment in the Eritrean mining sector. And as financing is sought, exploration continues with two companies reporting significant finds. Yet, despite enthusiasm from some for the possibilities, political realities combined with burdensome GSE requirements and restrictions may prevent the GSE from reaping the greatest of rewards. End Summary.

IMPRESIONABLE INVESTORS COME TO TOWN AND THE GSE IMPRESSES  
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¶2. (C) Both Nevsun and Sanu Resources supported visits from potential investors in the past 2 months. The style and approach differed greatly. For three days Nevsun together with the GSE entertained export credit agencies from Canada(EDC) and South Africa(ECIC), Proparco (investment arm of the French development agency) Standard Bank, and the European Investment Bank(EIB). The IFC and the Dutch and German development funds were invited but did not attend for various reasons. The entire visit was planned without prior discussion or input from the development banksQ country missions in Eritrea, many of whom are skeptical about the wisdom of investment in Eritrea for reasons ranging from concern over lack of transparency in terms of mining sector policies to broader unhappiness with the GSEs record on economic policy, governance, and human rights generally. In the end the German development fund and the IFC did not attend after last minute discussions with their local missions.

¶3. (C) According to staff of the European Commission and the local director of the World Bank, the GSE and Nevsun gave an Oscar-worthy performance which, in their view,

mislead those who visited. The visitors met with the Ministers of Mining, National Development, and Finance, toured sites, and even had an "unexpected" meeting with President Isaias. A bootleg (not for public discussion) copy of the EIB report of the visit states "The Bisha Project itself, which can expect to become a highly profitable operation does not feature any serious technical or market difficulties. Environmental and social issues are being adequately addressed." The report goes on, "The Government seems to be fully committed to the project and Nevsun receives all necessary supports." (Note: Nevsun has established its own subsidiary for the mining and is seeking investors in this new company. End Note.) The French Ambassador told us recently that the French participants in the visit were, like the EIB, very impressed by the GSEQs seeming openness and enthusiasm for foreign investment.

14. (C) Even when the EIB in its report later acknowledged potential problems, its articulation of these challenges suggests that the EIB views were colored by the GSEQs salesmanship. The EIB report, for example, acknowledges that the GSE unapologetically voiced its unwillingness to adhere to policies of the Extractive Industries Transparency Initiative (EITI). It went on, however, to seemingly accept at face value the GSEQs explanation that in consenting to EITI the GSE would have to accept that the international community did not trust them, and when according to the EIB report given Eritrea's history of abandonment by the international community, it is they, the GSE, who have reasons to mistrust the international community. Thus, insistence by development partners to the conditionalities of the EITI questions the sincerity of Eritrea's commitment to just and fair development and as such is unacceptable. Second, efforts to address the

"resource curse" and the risks associated with large financial windfalls for poor countries insult the GSEQs capabilities, intelligence and its sovereignty over the use of its own resources.

15. (C) Contrasted with Nevsun's big show, Sanu Resources quietly brought in one analyst from a private Canadian firm the middle of April. According to Sanu's country director, Estaphanos Ogbasghi, several more potential investors could visit in the next few weeks, however, it is possible that their visits could be delayed until the fall. While Nevun will do its own mining, Sanu anticipates completing all of the assessments and then selling the mining rights. Thus, Sanu is looking for potential buyers while Nevsun is looking for potential investors.

BUT WILL INVESTMENT REALLY FOLLOW?

6.(C) Yet, even with the hullabaloo around the GSE/Nevsun engineered presentation for possible investors and despite the GSEQs assertion that everything is order, concerns and difficulties lurk in the background. Demetrius Pohl, the Director of Sanu Resources shared with Poloff his major concerns regarding mining operations in Eritrea. First, is the GSEQs history of taking over profitable businesses. Second, under the current mining law the GSE could potentially reap up to 48% of the mining profits; complicating raising funds or securing buyers for the mining rights. Third, the potential under the existing law for the GSE to have nearly 30% ownership in a mining extraction company is inconsistent with the 10% ownership that has become the standard in other parts of Africa.

ENVIRONMENTAL IMPACT

17. (U) Pohl further explained that while the GSE and others may attempt to minimize the potential environmental impact, the effect of mining on the local communities will be significant. Of primary concern will be issues with water. While different mining techniques may be employed to

minimize the impact, regardless all mining requires a substantial amount of water. He expects extraction companies will need to develop dams to collect water for at least 18 months prior to extraction beginning. While the pumping of groundwater for mineral extraction is possible, the long term damage to the already precarious water table and to the environment offers a strong disincentive for this practice.

#### AND STILL MORE DISCOVERIES

17. (U) As mining companies plan for the future of extraction and begin looking for financing, the timeline keeps being extended. While Nevsun planned to have their environmental assessments and final deposit reviews completed by June 2006, they are still in process and now late fall is a more realistic deadline. Meanwhile, the mining companies continue to invest in new exploration. Sanu believes they have found another significant deposit near their initial discovery in Western Eritrea, although they will know more after the drilling is completed in the fall. Sunridge Gold Corp announced in May more promising results from the drilling of the Emba Derho volcanogenic massive sulphide (VMS) project near Asmara.

#### COMMENT

19. (C) Comment: The development of the mining sector continues to be perceived as critical to Eritrea's economic health and perhaps even as the cornerstone of economic recovery. Yet, the GSE's policies toward foreign investment and its repeated practice of nationalizing successful private firms undermine its ability to attract investment. While they may be able to impress some visitors, you can not fool all of the people all of the

time. Eventually, investors will dig past the topsoil and question the GSE's political unpredictability and its economic practices. In the interim, mining companies will continue to do their job, prospecting and encouraging high risk investment, with the hope that the payoff will be enormous. End Comment.

DeLisi